

## Client Brief

Individual Investments | ROMANIA

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### THE LAW ON ENCOURAGING INDIVIDUAL INVESTORS - BUSINESS ANGELS

On 2 June 2015, the Law no. 120/2015 on encouraging individual investors - business angels ("**Business Angels' Law**") was published with the Official Gazette.

According to the Explanatory Notes to the Business Angels' Law,<sup>1</sup> the Romanian Government, by means of the arrangements concluded by Romania with the International Monetary Fund, the European Commission and the World Bank, has undertaken to facilitate the access to cheap external financing for small and medium enterprises ("**SMEs**"), especially for start-ups and spin-offs.

Amongst the reasons for assuming this obligation was the fact that, in 2013, 91,52% of Romanian SMEs were self-financing because of the increasing level of risk aversion characterising Romanian banks which considered SMEs' business plans as "*non-bankable*".

What defines a business angel is his highly risky private contribution, also known as *seed* or *early stage capital*,<sup>2</sup> to businesses from certain sectors that, at a given time, are presenting a highly growing potential (e.g. IT, technology). While up to 30,000 business angels and 350 business angels networks have been recorded in the EU, in Romania these numbers amount only to 50 business angels, respectively to 3 informal business angels networks, including herein both local and foreign individual investors.

Given this current economic background, the Romanian Government contemplates encouraging both local and foreign individual risk capital, in order to support Romanian businesses in their early stages. Thus, the Business Angels' Law established a tax-relief regime for individual investors who invest in newly established Romanian SMEs, created as private limited companies ("**Targets**").

<sup>1</sup> Available at: <http://www.cdep.ro/proiecte/2015/000/20/6/em21.pdf>;

<sup>2</sup> *Evaluation of EU Member State Business Angel Markets and Policies*, Centre for Strategy & Evaluation Services, October 2012, page 1, available at: [http://ec.europa.eu/enterprise/dg/files/ba-rep\\_en.pdf](http://ec.europa.eu/enterprise/dg/files/ba-rep_en.pdf).

### ❖ The definition of "business angels" and the scope of the Business Angels' Law

The Business Angels' Law does not provide a definition for the "business angel" concept. Such definition is provided by the European Commission's Directorate General - Enterprise and Industry:

*"A knowledgeable private individual, usually with business experience, who directly invests part of his or her personal assets in new and growing unquoted businesses. Besides capital, business angels provide business management experience for the entrepreneur."*<sup>3</sup>

Nevertheless, as it follows, this definition is in line with the legal framework established by the Business Angels' Law for stimulating individual investors.

The Business Angels' Law applies to:

- ✓ Individual investors - Any natural person, meeting the following criteria:
  - a) Is a person who is not related to the Target in which he/she becomes a shareholder after having acquired shares in a share capital increase of the Target;
  - b) Invests in the Target an amount from EUR 3,000 to EUR 200,000 in RON equivalent;
  - c) His/her investment shall be related to the Target's main purpose of business and shall be subject to the business plan in relation to which the individual investor performs such investment;
  - d) May not acquire, as a result of the investment, either directly or indirectly, acting individually or jointly, more than 49% of the Target's share capital;
  - e) Has clean tax and criminal records.
  
- ✓ Targets - Any Romanian limited liability company, meeting the following criteria:
  - a) Is created as a limited liability company, according to Law no. 31/1990 on companies (the "**Companies Act**");
  - b) Has maximum 50 employees and an annual turnover below the RON equivalent of EUR 10 million;
  - c) Is regarded as an autonomous company under the Law no. 346/2004 on encouraging the creation of SMEs, respectively:
    - a. it holds less than 25% of the share capital/voting rights (the highest of the two values being relevant in this context) of another company(s), or
    - b. no more than 25% of its share capital/voting rights is held by another company(s);

However, even if the above-mentioned thresholds are exceeded, a company remains autonomous if its investors are not related, individually or jointly, to such company;
  - d) Is not subject to factual or formal insolvency, nor to schemes of arrangement or liquidation.

The Business Angels' Law does not apply to investments concerning businesses from the following sectors: (i) banking; (ii) insurance and reinsurance, capital markets, financial intermediary services and any other activity related to financial services; (iii) real estate transactions, real estate leases, real estate intermediary services, real estate development; (iv)

<sup>3</sup> Ibid 2 - [http://ec.europa.eu/enterprise/policies/finance/glossary/index\\_en.htm#](http://ec.europa.eu/enterprise/policies/finance/glossary/index_en.htm#).

gambling and betting; (v) steel production and trade; (vi) charcoal production and trade; (vii) maritime and river ship construction; (viii) production or trade of guns, ammunition, explosive, tobacco, alcohol, substances under national surveillance, plants, narcotics and psychotropic substances; (ix) consultancy services in any field.

#### ❖ Investment procedure

The Business Angels' Law requires, for investment purposes, the conclusion of a contribution agreement between the business angels and the shareholders of the Target.

Such agreement must provide for the following aspects: (i) the capital raising scheme shall take place through issuance of shares and (ii) the value of the related premium. This agreement is subject to registration with the Trade Registry.

The individual investor will acquire the shares issued by the Target at their nominal value and will pay an issuance premium.

Nevertheless, in line with the purpose of the Business Angels' Law, i.e. supporting SMEs through the infusion of an early stage capital, a 3-year interdiction for the distribution of the issuance premium among the shareholders of the Target is set forth.

#### ❖ The tax-relief regime applicable to business angels

Any individual investor who falls within the scope of the Business Angels' Law benefits from the following tax-reliefs:

1. Dividend tax relief: business angels are exempted from the tax on dividends for a period of 3 years from acquiring the shares, provided that such shares are not transferred until the expiry of such period;

The above-mentioned tax incentive is capped in the sense that the aggregate value of the amounts to which the tax relief applies may not exceed the value of the investment of all business angels.

2. Capital gains tax relief: business angels are exempted from the tax on capital gains provided that the transfer takes place after at least 3 years from acquiring the shares.

Nevertheless, in the case of a transfer of shares by an individual investor to another individual investor (who is not a shareholder of the Target) within a three-year term as of their acquisition, the latter will benefit from the fiscal incentives for the remaining period until the expiry of such three-year term, while the transferee must return the tax incentives, namely the tax on dividends plus related accessories and the tax on capital gains resulting from the transfer of his shares.

However, if several business angels are investing in the same Target, the above-mentioned tax incentives may only be granted with reference to maximum 49% of the share capital of the respective Target, *pro rata* to the related stakes held by each business angel.

Furthermore, the above-mentioned tax incentives are subject to the following cumulative conditions:

- a) The articles of association of the Target, as registered with the Trade Registry, shall provide the following clauses:
  - i. The shareholders' participations to gains/losses shall be *pro rata* to their respective stakes in the company;
  - ii. The decisions regarding the business plan and the distribution of profits resulting from the investment are subject to unanimous consent of the shareholders;
- b) The issuance premium will not be distributed for a period of at least 3 years starting from the registration of the business-angel with the Trade Registry;
- c) The Target has no debts towards the consolidated State budget at the time of the business angel's exit.

\* \* \*

If you are interested in receiving further information on this topic, please do not hesitate to contact us.

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